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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 667.

UNITED STATES OF AMERICA, *Petitioner*,

v.

HARRY A. KAPLAN, *Respondent*.

On Writ of Certiorari to the Court of Claims.

BRIEF FOR RESPONDENT.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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CASES CITED.

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BRIEF FOR RESPONDENT.

OPINION BELOW.

The special findings of fact, conclusions of law, and opinion of the Court of Claims are reported in 18 F. Supp. 965.

JURISDICTION.

The judgment of the Court of Claims was entered April 26, 1937. A motion for a new trial was filed by the United States on June 24, 1937, and was denied by the Court on October 4, 1937. Petition for certiorari was granted by

this Honorable Court on February 14, 1938, and the case was assigned for argument immediately following No. 528, *Pacific National Company* v. *Welch, Former Collector.* The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED.

During the year 1929 the respondent sold 25 shares of stock in "1100 Park Avenue" for $250,000.00 and paid a commission on said sale of $10,000.00, leaving a net selling price of $240,000.00. The 25 shares of stock cost the respondent $46,000.00. The respondent reported on his Federal income tax return for 1929 the sum of $194,000.00 as profit on the sale taxable for the year 1929. Said reported profit on the sale was computed by respondent by subtracting $46,000.00, cost price, from $240,000.00, net selling price (R. 5).

However, under the terms of the agreement of sale the respondent received $25,000.00 down on the date of the sale of the stock and the balance of the purchase price was payable by the vendee in monthly installments of $1,875.00 each over a period of ten years (R. 5).

In all, the respondent received from the sale during the year 1929 the sum of $30,625.00, which was less than 40 per cent of the amount of the purchase price of $250,000.00 (R. 5).

The Internal Revenue Agent in Charge at New York City subsequently notified the plaintiff that an over-assessment of $2,084.20 for the year 1929 would be recommended on the basis of the respondent's right to report the profit from the sale on the installment basis (R. 5).

The respondent thereafter filed a claim for refund, which was denied by the Commissioner of Internal Revenue, on the ground that the respondent had no right to compute the profit on the installment basis after filing his return and showing a profit of $194,000. The respondent for the year 1929 kept his accounts and filed his Federal income

tax return on the cash receipts and disbursements basis (R. 5).

The case therefore presents the following questions:

I.

Whether a profit of $194,000 truly, correctly and reasonably reflects the respondent's income from the sale for the year 1929.

II.

Whether the respondent's error in reporting excessive income for the year 1929 may be corrected by the filing of a claim for refund.

III.

Whether the respondent is precluded from claiming the installment method for reporting profit on the sale by having filed his return on the basis of a completed profit of $194,000.

STATUTE AND REGULATIONS INVOLVED.

The pertinent statute and regulations involved in this case are printed in the Appendix, *infrà,* p. 19.

STATEMENT.

The Court of Claims made the following special findings of fact:

1. A joint income tax return of plaintiff, Harry A. Kaplan, and his wife, Ethel, for the year 1929 was filed March 15, 1930, indicating a total tax of $2,084.20, which was paid —$584.20 on March 17, 1930, and the balance of $1,500 in the amount of $500 each on June 13 and October 16, 1930, and $500 on July 23, 1931. For 1929 and all subsequent years plaintiff kept his books of account and made his Federal tax returns on the cash receipts and disbursements basis.

Included in the gross income in the return was an amount of $194,000, being the difference between a net selling price of $240,000 and a purchase price of $46,000 paid in June, 1928, for shares of stock in "1100 Park Avenue" which Harry A. Kaplan, April 11, 1929, agreed to sell under a contract whereby the purchaser was to pay $250,000 as follows: $25,000 down and $225,000 in monthly installments of $1,875 beginning October 1, 1929, together with interest, the shares in the meantime to be deposited in escrow. The plaintiff in 1929 paid $10,000 commission on the transaction, making the net selling price to him $240,000. On December 28, 1929, plaintiff agreed to an assignment made September 23, 1929, by the purchaser of his obligations under the contract to a third party, the Comas Holding Corporation.

During 1929 plaintiff received from the purchaser or his assignee $30,625 on the sale contract; in 1930 he received $22,500 in monthly installments of $1,875; and in the first three months of 1931, $5,601.51, after which time the agreed payments ceased. By agreement of August 12, 1931, between Ethel Kaplan, to whom plaintiff has assigned his interest in the contract for a nominal consideration, and the Comas Holding Corporation, the balance of $191,273.49 was to be paid $2,273.49 down and $2,000 monthly beginning September 1, 1931. In 1931 there was paid to plaintiff on the revised agreement $6,273.49 to the end of October, at which time payments again ceased. A further agreement was entered into March 19, 1932, between Ethel Kaplan and the Samuel Silver Realty Co., Inc., whereby the former agreed to sell the same shares of stock to the latter for $75,000, payable $750 down and the balance in monthly installments of $750 beginning April 10, 1932.

2. Plaintiff filed a joint income tax return for himself and wife for 1930 on March 16, 1930, showing no taxable income and no sale of stock in "1100 Park Avenue" or profit or loss thereon. Plaintiff filed no income tax return either for 1931 or 1932.

3. Internal Revenue Agent in Charge, R. T. Miles, New York City, notified plaintiff by letter November 18, 1931, of his decision, after audit and investigation of the 1929 return, to recommend an over-assessment of $2,084.20 for 1919 (the record shows this date to be 1919, but it should be 1929) conceding plaintiff's right to compute the tax on the sale here involved on the installment basis.

February 29, 1932, the Commissioner of Internal Revenue notified plaintiff of his disapproval of the internal revenue agent's report and stated that no over-assessment was disclosed.

4. March 12, 1932, plaintiff filed a claim for the refund of $2,084.20 for 1920, (the record shows this date to be 1920, but it should be 1929) on the ground that he was lawfully entitled to report the stock-sale transaction on the installment basis. The Commissioner of Internal Revenue rejected this claim January 23, 1933.

The Court also found (R. 8):

> "Moreover, the basis on which plaintiff reported the transaction in his return for 1929 and the basis on which the Bureau held him taxable when the claim for refund was finally rejected in 1933 did not clearly reflect plaintiff's income. In March, 1932, almost a year before the Commissioner rejected plaintiff's refund claim, the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000. The maximum amount which plaintiff therefore could ever receive under the contract for sale of the stock was $139,999 instead of a net selling price of $240,000, which is $54,000 in excess of the sum stated as profit in the return for 1929."

SUMMARY OF ARGUMENT.

I.

The profit of $194,000 from the sale reported by the respondent in his income tax return for the year 1929 did not truly, correctly or reasonably reflect the respondent's income for the year 1929.

II.

The basis adopted by the respondent for reporting the transaction in his 1929 income tax return did not constitute a binding election because the method used did not truly and correctly reflect the respondent's income.

III.

The cases relied on by the Commissioner are distinguishable from the case at bar inasmuch as they involve one of the following situations:

(a) The basis originally used by the taxpayer in reporting income did truly and correctly reflect income.

(b) Efforts by affiliated corporations to change from a consolidated return basis to a separate return basis or vice versa without the permission of the Commissioner although the returns originally filed correctly reflected income.

(c) Efforts of married persons to change from individual to joint returns or vice versa although the original returns filed correctly reflected income.

IV.

The question here involved is largely one of fact and we believe that the findings of fact of the Court of Claims should not, under the decisions of this Honorable Court, be disturbed upon appeal. The record sent up to this Court upon appeal does not contain the transcript of testimony

or the exhibits upon which the findings of the Court of Claims were based and there is no showing in this cause that the findings of fact of the Court of Claims were not based upon substantial evidence.

ARGUMENT.

I.

The Profit of $194,000 From the Sale Reported by the Respondent in His Income Tax Return for the Year 1929 Did Not Truly, Correctly, or Reasonably Reflect the Respondent's Income for the Year 1929.

The record discloses that the contract of sale provided for a total purchase price for the stock of $250,000. Of the said sum ($250,000), $25,000 was paid in cash on or about the date of sale and the balance, $225,000, was to be paid by the vendee in monthly installments of $1,875, over a period of ten years (R. 5).

The total amount collected under the contract by the respondent during the year 1929 was $30,625, which was less than 40 per cent of the purchase price of the stock. Also, during the year 1929, as found by the Commissioner, the respondent paid a brokerage fee of $10,000 in connection with the sale (R. 5).

During the year 1930 the respondent received $22,500 under the contract. His total collections for 1931 amounted to $11,874. During the three years 1929, 1930 and 1931 his total collections under the contract for the sale of the stock amounted to $64,999 (R. 5).

In March of 1932 the purchase price of the stock was reduced to $75,000. Therefore, the most that the respondent might ever hope to collect under the contract for the sale of the stock is $64,999, collected during the years 1929, 1930 and 1931, plus $75,000, representing the purchase price agreed to in 1932. This results in an aggregate amount of $139,999, which is the maximum amount that can be received by the respondent for the sale of the stock. Accord-

ingly, the profit reported by the respondent on his return for the year 1929, $194,000, was $54,000 in excess of the sum which he can finally hope to collect. (R. 5-8).

The Court of Claims found as a fact that the basis on which the respondent filed his return for the year 1929 did not clearly reflect the respondent's income. The Court stated in part as follows (R. 8):

> "Moreover, the basis on which plaintiff reported the transaction in his return for 1929 and the basis on which the Bureau held him taxable when the claim for refund was finally rejected in 1933 did not clearly reflect plaintiff's income. In March 1932, almost a year before the Commissioner rejected plaintiff's refund claim, the contract of sale of the stock in question was changed and the then unpaid purchase price thereof was reduced to $75,000. The maximum amount which plaintiff therefore could ever receive under the contract for sale of the stock was $139,999 instead of a net selling price of $240,000, which is $54,000 in excess of the sum stated as profit in the return for 1929."

II.

The Basis Adopted by the Respondent for Reporting the Transaction in His 1929 Income Tax Return Did Not Constitute a Binding Election Because the Method Used Did Not Truly and Correctly Reflect the Respondent's Income.

The wording of the law (Section 44, Revenue Act of 1928) which grants the taxpayer the privilege of reporting such a sale on the installment basis discloses no intent on the part of Congress to make a choice of one method or the other a binding election. The statute does not even use the word "election" in reference to installment sales of property. The statute merely states that the income from such a sale may be reported in the manner prescribed. Likewise, the Regulations (Regulations 74, Articles 352 and 353) do not even imply that a choice of one or the other

method in reporting the sale of property shall be construed as a binding election. There is nothing in the law or the regulations which makes respondent's original choice a binding election or which justifies the action of the Commissioner of Internal Revenue in refusing to allow respondent to make the change which he requested.

The United States Board of Tax Appeals has considered a number of cases where changes by taxpayers to or from the installment method of reporting income were involved. The rule adopted by the Board is that where the original method of reporting income does not truly or correctly reflect income the taxpayer is not bound to an election but may change to a method of reporting which does truly and correctly reflect the income from the transaction under consideration. *Key Largo Shores Properties, Inc.* v. *Commissioner,* 21 B. T. A. 1008, 1012; *Ives Dairy, Inc.* v. *Commissioner,* 23 B. T. A. 579, 584, affirmed 65 F. (2d) 135 (C. C. A. 5); *Boone, et al.* v. *Commissioner,* 27 B. T. A. 1064.

In *Key Largo Shores Properties, Inc.* v. *Commissioner of Internal Revenue, supra,* the Board of Tax Appeals held:

> "The fact that petitioner originally reported income from the sale of real estate on the installment basis does not preclude it from changing to the deferred payment basis where the installment basis does not correctly reflect income."

In the course of its opinion the Board declared as follows on page 1012 of 21 B. T. A.:

> "Under the Revenue Acts various methods of reporting income may be adopted by taxpayers, but all are designed to correctly reflect the true income in order that a just tax may be levied and collected. If a method used by a taxpayer does not clearly reflect income, the respondent may determine the income according to a method which in his opinion does clearly reflect it. Section 212, Revenue Act of 1926. This in itself is sufficient to demonstrate that it was not in-

tended that taxpayers should be irrevocably bound by the election of a method of reporting when that method is erroneous. The effect in this case of requiring adherence to the basis originally adopted by the taxpayer would be to set up and tax, as income, an amount which in fact is not income. Neither administrative rules nor the forceful arguments in favor of administrative expediency can create income where in fact there is none, and, after all, it is only income that is to be taxed. In our opinion the installment basis when applied to the facts in the present case does not reflect the taxpayer's income."

In *Boone et al.* v. *Commissioner*, 27 B. T. A. 1064, the Board held that where income was originally reported on the accrual basis the taxpayer could later change to the installment basis in order to clearly reflect income. At page 1067 of 27 B. T. A. the Board said:

"Respecting respondent's contention that because petitioners in their returns for 1920 reported the profit from the sale on an accrual basis they cannot now change to the installment basis, we again disagree. We have previously held that there was no statutory authority for reporting income on the installment basis under the Revenue Act of 1918, B. B. Todd, Inc., 1 B. T. A. 762; H. B. Graves Co., 1 B. T. A. 859; Hoover-Bond Co., 1 B. T. A. 929. Obviously, therefore, when petitioners filed their returns for 1920 they had no right to report the income from this sale on the installment basis. This privilege was accorded them by the provisions of section 212 (d) of the Revenue Act of 1926 as retroactively applied by section 1208 of the same act. To hold that petitioners can not change the method of reporting this installment sale would be contrary to the intention of Congress as expressed in these sections. Laurence H. Lucker, 21 B. T. A. 93; Potter Farms, Inc., 6 B. T. A. 111; Standard Computing Scale Co. v. United States, 52 Fed. (2d) 1018; M. L. Elken, 7 B. T. A. 1160; R. L. Brown Coal & Coke Co., 14 B. T. A. 609. Cf. Key Largo Shores Properties, Inc., 21 B. T. A. 1008."

The Commissioner relies on such cases as *Strauss* v. *Commissioner,* 33 B. T. A., 855, affirmed 87 Fed. (2d) 1018 (C. C. A. 2) *Rundel* v. *Commissioner,* 21 B. T. A. 1019; *Johnson Realty Trust* v. *Commissioner,* 21 B. T. A. 1333; *Ellis* v. *Commissioner,* 16 B. T. A. 1225; *Viault* v. *Commissioner,* 36 B. T. A. 430. However all of these cases involve the conclusion or finding that the basis first used by the taxpayer did correctly reflect income. In fact, the Board in *Key Largo Shores Properties, Inc.* v. *Commissioner, supra,* distinguished such cases at page 1011 of 21 B. T. A. as follows

> "The cited cases either presume or decide that the method first employed by the taxpayer served to reflect the true income and proceed on the theory that in such cases it is in the interest of administrative expediency to require adherence to the first method elected. * * *"

The United States Court of Appeals for the Fifth Circuit has reached the same conclusion. *Ives Dairy, Inc.* v. *Commissioner,* 65 Fed. (2d) 135. In fact, in the early case of *Morrow Becker & Ewing, Inc.* v. *Commissioner,* 57 Fed. (2d) 1, 2 (C. C. A. 5), the Court reversed the Board and stated in part, as follows:

> "* * * In this case the Commissioner put his refusal to allow the amended return on the ground that petitioner had chosen the installment basis for reporting profits and could not change. This gave no effect to changes in the law and regulations occurring afterwards. In view of the radical changes in the law, of which the petitioner had scant notice, if any, in fairness and justice to the taxpayer the returns should have been received and considered. Taxes are assessed on income and not on honest mistakes of the taxpayer. It was the duty of the Commissioner to do nothing arbitrary or unreasonable that would deprive petitioner of rights created by the new law and the regulations thereunder. It was a breach of discretion on the part of the Commissioner not to receive the amended return from 1925 under the circumstances disclosed."

The Court of Claims has consistently held that a taxpayer may change to the installment basis of reporting income where the original basis used did not truly reflect income. *Davis* v. *United States,* 71 Ct. Cls. 444, 46 Fed. (2d) 377, and opinion in the instant case.

Furthermore, the situation presented here is analogous to that presented under the capital net gain provision of Section 101 of the Revenue Act of 1928. That section provides:

> "In the case of any taxpayer other than a corporation who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, *at the election of the taxpayer,* be levied, collected and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½% of the capital net gain." (Italics supplied.)

In other words, the taxpayer may pay a tax at the rate of 12½ per cent of his capital net gain or may report the capital net gain as ordinary income and pay the ordinary tax rate on it. It should be noted that this section specifically provides that the taxpayer shall *elect* the method which he desires to use. In spite of the use of the phrase "election of the taxpayer" in the statute, it has been consistently held by the Bureau of Internal Revenue and by the Board of Tax Appeals that a choice of one or the other method is not a binding election but may be changed after the return is filed, if it is advantageous to the taxpayer to do so. In G. C. M. 2367, Int. Rev. Cumulative Bulletin VI-2, page 172, in considering Section 206 (b) of the Revenue Act of 1921, which corresponds to Section 101 of the Revenue Act of 1928, the General Counsel of the Bureau of Internal Revenue stated in said Cumulative Bulletin:

"It was evidently the purpose of section 206 (b) of the Revenue Act of 1921 to allow taxpayers with respect to capital gains to compute the tax either under that section or under sections 210 and 211 whichever would produce the lesser tax. The parenthetical expression 'at the election of the taxpayer' as used in section 206 (b) carried out this purpose and does not imply a technical election which once made is binding on the taxpayer. No real election is involved; that is, no election between two desirable alternatives, since obviously all taxpayers will desire to avail themselves of section 206 if it results in a lesser tax. In such a case, if that section is not availed of, it must be through ignorance or mistake."

In that memorandum the General Counsel ruled that a taxpayer who had filed his original return reporting his capital net gain as ordinary income should be allowed to amend his return and be taxed at the rate of 12½ per cent on his capital net gain. In G. C. M. 13466, published in September, 1934, in Internal Revenue Bulletin, Vol. XIII-1, page 144, the above rule was held to apply where at the time the original return was filed it was to the advantage of the taxpayer to return his capital net gain as ordinary income, but upon an audit of his return and an increase of his ordinary income, it became advantageous to the taxpayer to change his method of reporting said income and be taxed on his capital net gain at 12½ per cent.

The above quoted portion of G. C. M. 2367 was approved and the rule reiterated as follows:

"The conclusions reached in the foregoing rulings were based upon the theory that where a taxpayer has the right to be taxed at one of two rates he will always choose the lower rate, and that the 'election' to have capital gains so taxed really means the right to have such income taxed at the capital gain rate if it is more advantageous to the taxpayer. If the taxpayer does not elect to be taxed at the lower rate it will doubtless be due to ignorance or mistake and he should have the right to elect with full knowledge of all the facts and

the consequences of an election. The possibility of a taxpayer electing to be taxed at the higher rate is too remote for contemplation."

See also I. T. 2132, IV-1, C. B. 117, *James F. Hoey* v. *Comm.*, 4 B. T. A. 1043; *Fifth Third Union Trust Co.* v. *Comm.*, 20 B. T. A. 88.

The reasons advanced by the General Counsel in the above quotations in support of his ruling, that a choice of one of the two methods of reporting capital net gain does not constitute an election, apply with equal force to Section 44 of the Revenue Act of 1928 and support respondent's contention in regard to that section of the law. It is equally true that in the case of an installment sale of property all taxpayers would desire to avail themselves of the method which would result in the lesser tax and a failure to do so "must be through ignorance or mistake" and therefore there is no election between two desirable alternatives. There is no sound reason why a choice under Section 44 of the Revenue Act of 1928 should constitute a binding election when a choice under Section 101 of the same Act does not constitute a binding election, especially since Section 101 specifically provides that the method used shall be "at the election of the taxpayer." It is submitted that Congress did not intend that a choice by a taxpayer of one of the two methods allowed for the reporting of income from an installment sale of property should constitute a binding election, and that the Commissioner erred in so ruling and in refusing to allow respondent to correct the error made in the original return.

The instant case is distinguishable from the line of cases involving taxpayers on the accrual basis. If this taxpayer had been on the accrual basis of accounting and had reported the profit on the accrual basis as income for 1929, his return might have been correct for it would have reflected the profit for 1929 on the accrual basis of accounting. Accordingly he would not have had any error to correct by filing a claim for refund.

However, this taxpayer is on the cash basis of accounting. On that basis he did not derive a profit of $194,000 from the sale in 1929. On a cash basis his income for the year 1929 is distorted by reporting a profit of $194,000. On the accrual basis of accounting such a profit would perhaps have been correct. Therefore, inasmuch as the respondent reported for the year 1929 on a cash basis and reflected an erroneous and unreasonable profit from the sale, he is entitled to correct this error by means of a claim for refund. *Davis* v. *United States, supra.*

In *Bruce McDonald et al.* v. *Commissioner,* 52 Fed. (2d) 920, the United States Circuit Court of Appeals for the Fourth Circuit held that in the case of a casual sale of personal property the taxpayer was entitled to adopt the installment method of reporting the income from the transaction under consideration although the question was raised for the first time in the taxpayer's brief on appeal to the Circuit Court of Appeals. The Court pointed out in the concluding paragraph of its opinion that since the case had to be sent back to the Board of Tax Appeals for the correction of certain errors the petitioner might request the Board in further proceedings to apply the installment provisions of the statute.

III.

Cases Relied on by the Commissioner Distinguished.

The Commissioner relies on such cases as *Alameda Investment Company* v. *McLaughlin,* 33 Fed. (2d) 120 (C. C. A. 9); *Radiant Glass Company* v. *Burnet,* 54 Fed. (2d) 718 (App. D. C.), *Safety Electric Products Co. Inc.* v. *Helvering,* 70 F. (2d) 439 (C. C. A. 9); *Dr. Pepper Bottling Co.* v. *Commissioner,* 69 Fed. (2d) 768 (C. C. A. 5); *Lucas* v. *St. Louis National Baseball Club,* 42 F. (2d) 984 (C. C. A. 8).

These cases involve efforts by affiliated corporations after the time for the filing of returns to change either to or from separate or consolidated corporation income tax returns.

The Commissioner also relies on such cases as *Rose* v. *Grant,* 39 Fed. (2d) 340 (C. C. A. 5); *Buttolph* v. *Commissioner,* 29 Fed. (2nd) 695 (C. C. A. 7); *United States* v. *Pettigrew,* 81 Fed. (2d) 666, (C. C. A. 9) and *Morris* v. *Commissioner,* 40 Fed. (2d) 504 (C. C. A. 2). This line of cases involve efforts of married persons to make elated changes to or from separate or joint individual income tax returns. Such situations as were considered in the above cases involve real elections under the pertinent sections of the statute and regulations and there was no question but that the original returns filed clearly reflected the income. As pointed out hereinabove neither section 44 of the Revenue Act of 1928 nor the regulations of the Commissioner thereunder so much as imply that a choice of computing the profit on installment sales constitutes a binding election.

IV.

The Question Here Involved is Largely One of Fact and We Believe That the Findings of Fact of the Court of Claims Should Not, Under the Decisions of This Court, be Disturbed Upon Appeal.

In his specification of errors to be urged (p. 5 Petition for Writ of Certiorari) the Commissioner submits that the Court of Claims erred as follows:

> "In holding that the method or basis adopted by the taxpayer for reporting his taxable income for the year involved did not clearly reflect his income."

The Court of Claims found as a fact (R. 5) that for 1929 and all subsequent years the taxpayer kept his books of account and made his Federal income tax return on the cash receipts and disbursements basis. The Court of Claims further found (R. 8) that the basis on which the taxpayer reported the transactions here involved in his 1929 return did not clearly reflect the taxpayer's income. There is no showing by the Commissioner in this case that the findings

of fact of the Court of Claims were not supported by substantial evidence. The Transcript of Record, upon which the findings of the Court were based, has not been sent up to this Court with the exhibits as part of the record in this cause. It is therefore respectfully submitted that the Commissioner has failed to substantiate his contention that the Court of Claims erred in its findings of fact. *Helvering* v. *Rankin*, 295 U. S. 123; *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200; *Elmhurst Cemetery Company* v. *Commissioner*, 300 U. S. 37.

It is further submitted that the Commissioner cannot successfully urge that a finding of fact contained in the opinion of the Court below should not be considered as a finding of fact upon appeal. *Bradley W. Palmer* v. *Commissioner*, 302 U. S. 63.

In his brief in opposition to petition for Writ of Certiorari in *Pacific National Company* v. *Welch*, No. 528, the Commissioner stated the following, at page 12:

> "* * * In Kaplan v. United States, 18 F. Supp. 965, the Court of Claims held, though upon insufficient findings of fact, that the taxpayer, who was upon a cash receipts basis, had erroneously and mistakenly reported in his return for the taxable year the entire profit which it appeared at the time might ultimately be received but which was not actually received, and that the basis on which he reported the transaction did not clearly reflect his income. While we do not believe that that decision is correct we think it is distinguishable from the present case when read in the light of the opinion of the Court of Claims in LeBolt & Co. v. United States, 67 C. Cls. 422 * * *"

This would indicate that the Commissioner believes that the questions involved in the instant case are largely ones of fact and that the case is distinguishable from the *Pacific National Company* v. *Welch*, No. 528, because of the findings of fact by the Court of Claims showing that the taxpayer in filing his return for the year 1929 did not clearly reflect the

income from the casual sale of personal property here involved.

CONCLUSION.

It is respectfully submitted that the decision of the Court of Claims was correct and should be affirmed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

PART II—COMPUTATION OF NET INCOME

Sec. 21. Net income.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

Sec. 22. Gross income.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * * * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

Sec. 41. General rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section

48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in personal property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of realty and casual sales of personalty.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the

selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) *Change from accrual to installment basis.*—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

SUPPLEMENT B—COMPUTATION OF NET INCOME

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

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(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) *Installment sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment pay-

ment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss determined under section 111, shall be recognized, except as hereinafter provided in this section.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

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Treasury Regulations 74:

ART. 321. *Computation of net income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331-333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. *Bases of computation.*—Approved standard methods of accounting will ordinarily be regarded as

clearly reflecting income A method of accounting will not, however be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. * * *

ART. 331. *When included in gross income.*—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. * * *

ART. 351. *Sale of personal property on installment plan.*—

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In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

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SUPREME COURT OF THE UNITED STATES.

No. 667.—October Term, 1937.

United States of America, Petitioner, *vs.* Harry A. Kaplan.	On Writ of Certiorari to the Court of Claims.

[May 2, 1938.]

Mr. Justice Butler delivered the opinion of the Court.

Respondent and his wife in a joint return of income tax for 1929 reported a profit of $194,000 from the sale of 25 shares of the stock of "No. 1100 Park Avenue," and disclosed tax of $2,084.20 which was paid. The taxable income was less than the profit in question. It resulted from the sale by him, April 11, 1929, for a net price of $240,000 of stock bought in 1928 for $46,000. The buyer agreed to pay $25,000 cash and the balance in installments of $1,875 a month. For 1930, respondent and his wife filed a return showing no taxable income. For 1931 and 1932, respondent filed no returns. In 1932 he filed a claim for refund of the entire 1929 income tax. The ground for the claim was that he was entitled to report the sale on the installment basis. The findings indicate that the deferred payments were worth less than face value; after respondent and his wife (to whom he assigned the contract) had received $55,000, they agreed to accept $75,000 more as full payment. The commissioner rejected the claim and this suit followed. The Court of Claims gave respondent judgment. 18 F. Supp. 965. This Court granted a writ of certiorari because of conflict between the decision and that of the circuit court of appeals for the ninth circuit in *Pacific National Company* v. *Welch*, 91 F. (2d) 590, this day affirmed. The question here presented is the same as the one decided in that case. The judgment of the court below must be reversed.

It is so ordered.

Mr. Justice Cardozo and Mr. Justice Reed took no part in the consideration or decision of this case.